DEPARTMENT OF TELECOMMUNICATIONS AND ENERGY

RESPONSE OF BAY STATE GAS COMPANY TO THE
SUPPLEMENTAL RECORD REQUESTS OF THE
DEPARTMENT OF TELECOMMUNICATIONS AND ENERGY
D.T.E. 01-81

Date: February 14, 2003

Witness Responsible: Francisco C. DaFonte

DTE-RR Sup. 1-1:

Please refer to Exh. BSG-2 (i.e., the Prefiled Direct Testimony and Attachments of Karl E. Stanley) at 16-17. Bay State stated that the GCIM would be subject to an annual net realized loss limit of $5,000,000 and that the monthly and annual position limits of 100 NYMEX equivalent and 1,000 NYMEX equivalent contracts also would apply to Bay State's activities, which represents slightly less than 25 percent of Bay State's normal year requirements.

(A) Please explain what Bay State means by "normal year requirements."

(B) Please explain the basis for the calculation of the loss limit of $5,000,000.

(C) Please explain how the loss limit of $5,000,000 is related to the "slightly less than 25 percent of Bay State's normal year requirement" referred to above.

(D) Please explain how the loss limit would change if the Company were to trade more than 25 percent of its normal year requirements. In your response, please calculate the potential loss limits if the Company trades 50 percent, 75 percent, and 100 percent of its normal year requirements.

Response:

(A) Bay State's normal year requirements were based on its firm sales demand forecast provided in the 2001-2002 winter CGA filing, which was approximately 40 Bcf. Bay State's domestic gas purchases excluding storage injections are equal to approximately 25% of that amount.

(B) As noted in Mr. Stanley's direct testimony at page 17, lines 15-17, the annual loss limit was established as a means of providing a backstop to limit exposure to reasonable levels in the event of adverse market fluctuations. The loss limit is in addition to the position limits established by the maximum number of contracts that may be open for any month and year. The $5,000,000 loss limit was calculated by multiplying the 1,000 NYMEX equivalent contract limit by a $.50 per Dth parallel curve shift for the 12-month futures contract strip. This parallel curve shift would constitute, on average, a $.50 per Dth movement in the NYMEX futures contracts over the 12-month strip. Since a $.50 parallel curve shift has never been experienced in the market in a given trading session, the Company deemed this to be an appropriate volatility factor in establishing its net realized loss limit. Therefore, since each NYMEX contract is equivalent to 10,000 Dth, multiplying the 1,000 contract limit by the NYMEX contract equivalent volume yields a total volume limit of 10 Bcf. Multiplying the 10 Bcf limit by the $.50 shift yields the $5,000,000 net realized loss limit.

(C) As described in Mr. Stanley's testimony at pages 16-17, two separate risk limits would apply to the Bay State GCIM. The volume risk limits are 100 NYMEX equivalent contracts per month and 1,000 NYMEX equivalent contracts per year, which equates to approximately 25% of Bay State's normal year requirements. As explained in the response to (A) above, Bay State's normal year firm sales requirements were approximately 40 Bcf for the 2001-2002 winter CGA filing, dividing the 10 Bcf futures contract volume limit in (B) above by the 40 Bcf of normal year firm sales yields approximately 25 percent. This 25% is approximately equal to Bay State's domestic gas purchases excluding storage injections. The loss limit of $5,000,000 is related to the position limits in that it represents the loss that would be incurred under a hypothetical parallel curve shift of $0.50 assuming the maximum level of open positions of 1,000 NYMEX contracts, or 10,000,000 Dth. Specifically, $5,000,000 equals $0.50 per Dth times 10,000,000 Dth. However, the $5,000,000 provides an important additional safeguard against incurring unacceptable losses over the entire year.

(D) The loss limit is fixed at $5,000,000 annually and would not change. As explained in the response to (B) above, the Company has established a net realized loss limit based on no more than

1,000 NYMEX equivalent contracts, or 25 percent of its normal year firm sales requirements. Therefore, the Company would not enter into more than 1,000 NYMEX equivalent contracts annually or 100 NYMEX equivalent contracts monthly as this would violate the Energy Supply Services Risk Policy.

The Company is not seeking to increase the GCIM trading limit above 25% of normal year firm sales requirements (equal to 100% of domestic gas purchases excluding storage injections). Assuming hypothetically that the Company intended to increase its trading limits and assuming the same conservative $0.50 per Dth shift, the potential loss for 50% would be $10 million; for 75%, $15 million and for 100%, $20 million.